IN THE

Supreme Court of the United States

October Term, 1942

No.....

MARGARET CAHN RAPHAEL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions in the Courts Below.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported at 133 Fed. (2d) 442. The opinion of the Board of Tax Appeals is reported under the title *Francois Lang et al. v. Commissioner*, at 45 B. T. A. 256.

II.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240, subdivision (a), of the Judicial Code, as amended by the Act of February 13, 1925, c. 229 (43 Stats. 939; 28 U. S. C. A., sec. 347), to review a decision of the Circuit Court of Appeals for the Ninth Circuit filed February 1, 1943 [R. 103]. A petition for rehearing was denied on March 15, 1943 [R. 104].

III.

Statement of the Case.

Although the petitioner is now a resident of the State of New York [R. 71], she was during the taxable year in question a non-resident alien individual not engaged in trade or business within the United States and not having an office or place of business therein [R. 5, 18].

The petitioner and others, or their predecessors in interest, held title as tenants in common to several thousand acres of land in Kern County, California. The Anglo California National Bank of San Francisco (hereinafter referred to as the bank) for several years had been the agent of the owners of the lands and had in its possession powers of attorney in respect to them. Herbert Fleishhacker was the president of the bank. In May of 1915 the bank, acting under the powers of attorney, caused 110 acres of the land to be sold for $33,000. This 110-acre parcel at the time of the sale had a market value of $260,000. In March of 1917 the bank and Fleishhacker, acting under the powers of attorney, sold 40 acres of the land for $13,500. This 40-acre tract at the time had a market value of $40,000. The owners consented to the sales in reliance upon fraudulent misrepresentations made to them by the bank and Fleishhacker [R. 39-40].

In 1933 the petitioner and others filed an action against Fleishhacker, the bank, and other named individuals and corporations, in the United States District Court for the Southern District of California [R. 40]. In this action the trial court found that:

> "By reason of the fraudulent acts and conduct of the Bank and Fleishhacker * * * with respect to the * * * sale of the 110 acres on or about

May 24, 1915 [the plaintiffs were damaged] in the amount of $227,000, representing the difference between the market value of said 110 acres on said date, $260,000, and the sum of $33,000 received therefor, together with interest on the said sum of $227,000 from the date of said sale; and, with respect to the * * * sale of 40 acres on or about March 22, 1917, the said plaintiffs had been damaged in the amount of $26,500, representing the difference between the market value of said 40 acres on said date, $40,000, and the sum of $13,500 received therefor, together with interest on the said sum of $26,500 from the date of said sale in 1917."

The court concluded that the plaintiffs were:

"* * * entitled to judgment against [Fleishhacker and the Bank] in the sum of $253,500, together with interest from May 24, 1915, to date of judgment at the rate of seven per cent (7%) per annum on the sum of Two Hundred Twenty Seven Thousand Dollars ($227,000), plus interest at the same rate from March 26, 1917, to date of judgment on the sum of Twenty-six Thousand Five Hundred Dollars ($26,500), and for their costs and disbursements in this action." [R. 41-42.]

On January 11, 1938, judgment was entered in the amount of $651,579.71 (exclusive of costs), of which $398,079.71 was computed as an amount equal to seven per cent per annum on $227,000 from May 24, 1915, to January 11, 1938, and seven per cent per annum on $26,500 from March 26, 1917, to January 11, 1938 [R. 29].

The bank and Fleishhacker took an appeal to the Ninth Circuit Court of Appeals, which affirmed the judgment.

Anglo California National Bank v. Lazard, 106 Fed. (2d) 693. A petition for certiorari was denied by this Court on January 2, 1940 [R. 42]. On January 19, 1940, the full amount of the judgment, together with interest thereon in the sum of $92,644.93, or a total of $743,925.60, exclusive of taxable costs, was received by the plaintiffs in satisfaction of the judgment [R. 42].

The petitioner filed with the Collector of Internal Revenue for the District of Maryland an income tax return for the fiscal year ending January 31, 1940, on a cash receipts and disbursements basis, reciting that she had received a 17/300th part of the total sum paid in satisfaction of the judgment, but asserting that no part of the sum so received was annual or periodical gain, profit or income subject to taxation [R. 38-39]. In his notice of deficiency, however, the Commissioner took the position that, aside from a conceded exclusion of $299.04, all of the aforesaid sum of $398,079.71 included in the judgment, plus the $92,644.93 paid as interest on the judgment, or a total sum of $490,425.60, constituted "fixed or determinable annual or periodical" income taxable under Section 211 of the Internal Revenue Code, and therefore determined a deficiency in tax of $3,676.18, based upon the petitioner's receipt of 17/300ths of the said sum of $490,425.60 [R. 12-13].

On May 18, 1940, the petitioner filed a petition for redetermination of this asserted deficiency of $3,676.18 [R. 4]. On May 22, 1940, she paid the said sum to the Collector of Internal Revenue [R. 19] and then filed a supplement to her petition, asking the Board to determine an overpayment in the full amount [R. 17].

The Board of Tax Appeals, in an opinion reported in 45 B. T. A. 256 under the title of *Francois Lang et al. v. Commissioner,* held that the $398,079.71 included in the judgment was not taxable income under Section 211, but that the $92,644.93 paid as interest on the judgment was. Upon this reasoning, the petitioner's 17/300ths share of $92,644.93, or $5,249.88, was subject to a tax of 10%, or $524.99. The Board therefore decided that the overpayment amounted to $3,151.19, the difference between the sum of $3,676.18 paid and the said tax of $524.99 [R. 60-61].

This decision was assigned as error in a petition for review filed by the Commissioner with the Circuit Court of Appeals for the Ninth Circuit [R. 66-68]. The Circuit Court of Appeals reversed the Board in an opinion filed February 1, 1943 [R. 90-102] and on March 15, 1943, denied a rehearing [R. 104].

IV.

Specifications of Error.

The Circuit Court of Appeals erred:

(1) In holding that the $398,079.71 was "interest" within the meaning of Section 211(a)(1)(A) of the Internal Revenue Code.

(2) In holding that the liability of the defendants to pay the difference between the price and true value of the lands sold was an "interest-bearing obligation" within the meaning of Section 119(a)(1) of the Internal Revenue Code.

(3) In holding that the $398,079.71 constituted a periodical gain within the meaning of Section 211(a)(1)(A) of the Internal Revenue Code.

V.
Summary of Argument.

(1) Sums received as damages, measured by the use of an interest computation, are not amounts "received . . . as interest," within the meaning of Section 211 (a)(1)(A) of the Internal Revenue Code.

(2) The liability of a tortfeasor to pay damages is not an "obligation" within the meaning of Section 119(a) of said Code.

(3) An obligation to which "interest" may or may not be added, in the discretion of the trial judge, is not an "interest-bearing" obligation within the meaning of Section 119(a).

(4) The phrase "interest on * * * interest-bearing obligations" in Section 119(a) cannot properly be construed as embracing every conceivable type of interest. This language necessarily excludes an award of damages of the type here involved.

(5) Income is not "periodical," within the meaning of Section 211(a)(1)(A), unless the recipient becomes from time to time unconditionally entitled to receive it.

(6) There can be no "periodical gains" within the meaning of Section 211(a)(1)(A) which are not periodical income.

VI.
ARGUMENT.

A. Introduction.

The questions presented on this review involve the interpretation of Section 211(a)(1)(A) of the Internal Revenue Code, reading as follows:

> "There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 11 and 12, upon the amount received, by every nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, a tax of 10 per centum of such amount, except that such rate shall be reduced, in the case of a resident of a contiguous country, to such rate (not less than 5 per centum) as may be provided by treaty with such country."

This provision was first enacted, in precisely the same language, as Section 211(a) of the Revenue Act of 1936.

The opinion of the Circuit Court of Appeals in this case does not accurately state the contentions of the petitioner and is built upon a series of unsound premises. In the first place, the court quotes the general provision in Section 3281 of the California Civil Code that every person who suffers detriment from an unlawful act or omission may recover damages, and from this concludes that the liability of Fleishhacker and the bank to pay as dam-

ages the difference between the price and the true value of the lands sold was an obligation "created" by statute [R. 94-95]. Petitioner respectfully submits that liability in damages was a fundamental concept of the common law and that the statute is merely declaratory of principles long established. Section 5 of the California Civil Code expressly states that

> "The provisions of this code, so far as they are substantially the same as existing statutes or the common law, must be construed as continuations thereof, and not as new enactments."

Similarly, the opinion cites Section 3288 of the Civil Code, which provides that interest may be awarded in fraud actions "in the discretion of the jury," as showing that in California "the interest is awarded as 'interest,' as distinguished from its merger in a total damage" [R. 95]. The opinion ignores the fact that Section 3288 is found in Title II, Chapter I, Article II, of the Civil Code, under the heading "Interest as Damages."

The opinion makes it appear that the petitioner, in presenting her case, accepted and based her argument on these erroneous premises. Thus, the Circuit Court of Appeals says [R. 96]:

> "Taxpayer also contends that because the obligation of the agents to the principal for a money payment is created by statute and not by contract, it is not the kind of obligation upon which the statutory interest is taxable under the Federal Code."

As a matter of fact, as will appear from an examination of petitioner's brief before the Circuit Court of Appeals, the petitioner argued before that court, and it is petitioner's

contention here, that the liability of Fleishhacker and the bank was not created, but was merely declared, by statute; that the sections of the Civil Code above mentioned are entirely irrelevant; and that the $398,079.71 was not received as interest on an "interest-bearing obligation," the reason being that no obligation, statutory or otherwise, can be said to be interest-*bearing* which does not carry with it a *right* to interest.

B. The $398,079.71 Was Not an Amount Received as Interest on an Interest-bearing Obligation.

It is the contention of respondent that the $398,079.71 included in the judgment against Fleishhacker and the bank was, within the meaning of Section 211(a)(1)(A) of the Internal Revenue Code, an "amount received * * * from sources within the United States as interest." In order to evaluate this contention it is necessary, first of all, to consider the significance of the phrase "from sources within the United States."

Section 119(a)(1) defines "gross income from sources within the United States" as including

> "Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—
>
> (A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States, or
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> (B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of

> the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable, or
>
> (C) income derived by a foreign central bank of issue from bankers' acceptances."

Section 119(c) provides that there "shall be treated as income from sources *without* the United States:

> (1) Interest other than that derived from sources within the United States as provided in subsection (a)(1) of this section."

Section 212(a) provides that:

> "In the case of a non-resident alien individual gross income includes only the gross income from sources within the United States."

It is therefore apparent that no tax is imposed upon interest by Section 211(a)(1) other than such interest as is described in Section 119(a)(1). The question, therefore, is whether the $398,079.71 was received as "interest on bonds, notes, or other interest-bearing obligations."

Although the respondent contended before the Circuit Court of Appeals that only $253,500 of the judgment against Fleishhacker and the bank was awarded to the plaintiff as damages and that the balance of the judgment consisted of interest, there can be no dispute as to what actually occurred. The trial court recognized two ele-

ments of damage sustained by the plaintiffs as a result of the deceit practiced upon them by the defendants—(1) the damage which they sustained at the time of the sales in 1915 and 1917 in being deprived of valuable lands, an element measured by the difference ($253,500) between the price which they received ($46,500) and what the Court, upon conflicting evidence, found to be the market value of the land sold ($300,000); and (2) the damage which the plaintiff sustained between the time of the sales and the date of the judgment in being deprived of the use of this difference, an element which the Court measured by the amount which $253,500 would have earned over the period at simple interest, or $398,079.71 [R. 41]. The Court used the legal rate of interest, 7% per annum, merely as a convenient method of measuring one of the elements of damage. In affirming the judgment on appeal, the Circuit Court of Appeals recognized that the $398,079.71 was included in the judgment "as part of the total damages" [R. 49; 106 Fed. (2d) p. 704].

The petitioner's contention is that the $398,079.71 thus included in the judgment was not "interest on bonds, notes, or other interest-bearing obligations" within the meaning of Section 119(a)(1), and therefore that it was not an "amount received from sources within the United States as interest" within the meaning of Section 211 (a)(1)(A). This contention is supported, first of all, by a number of decisions holding that the word "interest" as used in federal statutes does not include damages awarded as compensation for delay in payment, even though such damages may be measured by an interest computation.

Thus, although Section 24 of the Judicial Code (28 U. S. C. A., Sec. 41(1)) confers jurisdiction on the dis-

trict courts where the matter in controversy exceeds a given sum "exclusive of interest," it was held, in *Brown v. Webster,* 156 U. S. 328, 39 L. ed. 440, that this did not refer to damages measured by interest. The Court said:

> "The argument is that the matter in dispute did not exceed $2000, exclusive of interest and costs, and hence the alleged want of jurisdiction. The demand of the plaintiff was for damages in the sum of $6000. This was the principal controversy. It is insisted, however, that, as under the law of Nebraska, damages in case of eviction involved responsibility only for the return of the price with interest thereon, and the price here was only $1200, the sum in controversy could not exceed $2000 exclusive of interest. That is to say, as the measure of the damage was price and interest, the price being below $2000, the jurisdictional amount could not be arrived at by adding the interest to the price. *This contention overlooks the elementary distinction between interest as such and the use of an interest calculation as an instrumentality in arriving at the amount of damages to be awarded on the principal demand.* As we have said, the recovery sought was not the price and interest thereon, but the sum of the damage resulting from eviction. All such damage was, therefore, the principal demand in controversy, although interest and price and other things may have constituted some of the elements entering into the legal unit, the damage which the party was entitled to recover." (Italics ours.)

And in *Chesbrough v. Woodworth* (C. C. A. 6), 251 Fed. 881, an action for damages for deceit, we find the following statement:

> "The action was one of tort, and the jury might have allowed her an annual percentage, not as col-

lateral interest, but as an element in giving her entire compensation for her loss. Damages of that kind, although computed at a percentage rate and equivalent to contract interest, would not be that 'interest' which the jurisdictional statute (then section 1 of Act of March 3, 1887; now section 24, Judicial Code, Act March 3, 1911, c. 231, 36 Stat. 1091 (Comp. St. 1916, Sec. 991)) says must be excluded. Brown v. Webster, 156 U. S. 328, 329, 15 Sup. Ct. 377, 39 L. Ed. 440. With 'interest' thus defined and damages thus estimated, the damages might have exceeded $2,000 when the suit was commenced."

Although Section 177 of the Judicial Code (28 U. S. C. A., Sec. 284) prohibits the allowance of interest on any claim against the United States prior to judgment in the Court of Claims, this Court has held that where property is taken for public use, the statute does not prevent the inclusion in the award of an amount measured by interest on the value of the property from the time of taking. In *Phelps v. United States*, 274 U. S. 341, 344, 71 L. ed. 1083, 1085, the Court said that the additional allowance was not a claim for interest within the purpose or intention of Section 177. The statement in *Jacobs v. United States*, 290 U. S. 13, 17, 78 L. ed. 142, 144, was to the same effect.

In *Shoshone Tribe v. United States*, 299 U. S. 476, 496, 81 L. ed. 360, 369, where the United States had violated treaty provisions giving an Indian tribe the exclusive right of occupancy of its reservation, the Court said:

"The claimant's damages include such additional amount beyond the value of its property rights when taken by the Government as may be necessary to the award of just compensation, the increment to be meas-

> ured *either by interest on the value or by such other standard as may be suitable in the light of all the circumstances.*" (Italics ours.)

This language clearly indicates that the use of an interest computation is merely one method of determining the damages to be awarded as compensation for delay in payment in cases such as this.

The distinction between interest as such and damages computed at a percentage rate was pointed out in *United States v. Klamath & Modoc Tribes*, 304 U. S. 119, 123, 82 L. ed. 1219, 1223, where the Court said:

> "* * * Nor is it quite accurate to say that interest as such is added to value at the time of the taking in order to arrive at just compensation subsequently ascertained and paid."

This language was quoted in the very recent case of *Kieselbach v. Commissioner of Internal Revenue*, 63 S. Ct. 303, 87 L. ed. (Adv. Op.) 281, 284, in a footnote in support of the following statement:

> "In any event the question here is not whether these sums are interest. They may not be interest and yet be other than part of the sale price. If not interest they may be compensation for the delay in payment."

The Court thus expressly recognized that compensation for delay in payment of money *is not necessarily interest* within the meaning of the Internal Revenue Code. Notwithstanding this statement, the Circuit Court of Appeals has announced as the very basis of its decision in the present case the proposition that compensation for delay in payment of money *is* necessarily interest [R. 98]. The cases of *Meilink v. Unemployment Reserves Commission*, 314

U. S. 564, 86 L. ed. 458, and *United States v. Childs*, 266 U. S. 304, 69 L. ed. 299, cited in support of this proposition, merely hold that a sum provided by statute as compensation for delay in payment of a debt is not a *penalty* within the meaning of the Bankruptcy Act.

In *Old Colony R. Co. v. Commissioner of Internal Revenue*, 284 U. S. 552, 560, 561, 76 L. ed. 484, 489-490, the Court said:

> "And as respects 'interest,' the usual import of the term is *the amount which one has contracted to pay for the use of borrowed money.*
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> * * * * * * * *
>
> "We cannot believe that Congress used the word having in mind any concept other than the usual, ordinary and everyday meaning of the term.
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> * * * * * * * *
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> "If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the tax payer." (Italics ours.)

The Board of Tax Appeals, in the instant case, said, with respect to the $389,079.71 here in issue [R. 51]:

> "Clearly, it was not interest in 'the usual, ordinary and everyday meaning of the term.' Old Colony Railroad Co. v. Commissioner, 284 U. S. 552."

If, however, the question is left in doubt by the foregoing decisions, it should be remembered that Section 211(a)(1)(A) does not impose a tax on all interest, but only interest on such obligations as are mentioned in Section 119(a)(1). The question here, as above stated, is

whether the $398,079.71 was interest on an "interest-bearing obligation," within the meaning of this latter section. In this connection the case of *N. V. Koninklijke Hollandische Lloyd,* 34 B. T. A. 830, is directly in point. The facts in that case were as follows: In 1917 the steamship Zeelandia, owned by the petitioner, a foreign corporation, was refused clearance papers by the United States, and was illegally detained for some months. By act of Congress the petitioner was empowered to sue the United States for damages in the Court of Claims, which rendered judgment in its favor for $446,825.22, together with interest in the sum of $84,531.73. In holding that the "interest" included in the judgment did not constitute income from sources within the United States, the Board said (p. 834):

> "Nor do we believe the payment, or any part of it, falls within the first subdivision entitled 'interest.' Under the well established rule, the 'interest' was included in the judgment as part of just compensation for damages sustained. *Seaboard Air Line Railway v. United States,* 261 U. S. 299; *Brooks-Scanlon Corporation v. United States,* 265 U. S. 106; *Phelps v. United States,* 274 U. S. 341. The Board held in *Consorzio Venesiano di Armamento e Navigazione,* 21 B. T. A. 984, that a payment by the United States to a foreign corporation as just compensation for the taking of property for public use, which payment included an amount equivalent to interest for the period of use, did not result in income under the section here involved. We see no difference of principle in the case at bar. Here, the stipulation denominated the sum of $84,531.73 as the 'amount received for damages measured by interest' and in its opinion the Court of Claims stated: 'The plaintiff is en-

titled to interest, as has been said, because such allowance is "rightful" and is necessary adequately to compensate it for the damage.' The facts here are more strongly in favor of the petitioner than those in the *Consorzio Venesiano di Armamento e Navigazione* case. Nor does the holding of the Supreme Court in *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, require a contrary result. There the court held (1) that under specific statutory provision a refund was an interest-bearing obligation of the United States, and (2) that the United States was a 'resident' within the meaning of the pertinent statute. Here the obligation of the United States is to make just compensation for the unlawful detention of the vessel. Just compensation for the damage so suffered requires that the party damaged be made whole. An integral part of a payment for such purpose is interest covering the period of detention. In such a case it is merely a convenient method of measuring the amount of one of the factors of damage. It is not a separable item of interest on an obligation."

This Board of Tax Appeals decision was cited by the Court in *Kieselbach v. Commissioner, supra*, as applying "the rule that payment for deferred compensation was not interest under Sec. 119(a)."

In considering whether the liability of Fleishhacker and the bank to pay as damages the difference between the price and true value of the lands sold was an "interest-bearing obligation," it is necessary, first of all, to examine the case of *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, 79 L. ed. 211, a case upon which both the petitioner and respondent rely. In that case, which was de-

cided at a time when Section 119 imposed the only restriction upon the types of income taxable to non-resident aliens, the question presented was whether interest on a tax refund was interest on an interest-bearing obligation. The Court held that inasmuch as Congress had found it necessary to make an express exception for interest on bank deposits, the words "interest-bearing obligations" must have been used in a sense broad enough to cover bank deposits, and that a meaning so broad would also include the statutory obligation to refund an overpayment of taxes. The gist of the decision is found in the following excerpt from the opinion (293 U. S. p. 91, 79 L. ed. pp. 216-217):

> "Interest on deposits is no more akin to notes and bonds than is interest on tax refunds; and the fact that the former was expressly excepted from the operation of the substantive provision quite clearly justifies the conclusion that the lawmakers attached to the general clause a larger meaning than it would have if limited to things *ejusdem generis* with those specifically enumerated. Certainly, if it was necessary to save interest on deposits from the embrace of the general clause by an exception, it was equally necessary to save interest on tax refunds by a like exception."

The respondent relies upon the *Stockholms Enskilda Bank* case as establishing that the word "obligations" is used in a broader sense in Section 119(a)(1) than if construed *ejusdem generis* with the preceding words "bonds" and "notes," a proposition which the petitioner readily concedes. This does not mean, however, that the word "obligations" is to be given the broadest possible meaning. Nothing in the Court's opinion requires the

word "obligations" to be taken from its setting and construed *in vacuo*. The decision is entirely consistent with the definition of the word "obligation" given in Webster's New International Dictionary, Second Edition, as "a formal and binding agreement or acknowledgment of a liability to pay a certain sum or do a certain thing." Under this definition, the mere assertion of a claim for damages based on deceit can not properly be spoken of as an "obligation" where the claim, as in the *Fleishhacker* case, is disputed in its entirety. Such a tort liability is unlike *any* obligation mentioned in Section 119(a)(1), either by way of inclusion or exception.

The Circuit Court of Appeals also cited the *Stockholms Enskilda Bank* case as refuting the contention, *never made by the petitioner*,

> "that because the obligation of the agents to the principal for a money payment is created by statute and not by contract, it is not the kind of obligation upon which the statutory interest is taxable under the Federal Code" [R. 96-97].

This is but another instance in which the Circuit Court of Appeals has misunderstood petitioner's contention.

The petitioner relies upon the statement in the *Stockholms Enskilda Bank* case (293 U. S. p. 86, 79 L. ed. p. 214) that

> "* * * an obligation upon which by express statutory direction interest *must* be paid is an interest-bearing obligation." (Italics ours.)

as indicating that an obligation to which interest may or may not be added, in the trial court's discretion, is *not* an interest-bearing obligation. The contention of the peti-

tioner is that no obligation is interest-bearing unless it carries with it a *right* to interest on the part of the obligee. In an action for damages for deceit there is no contractual provision, statutory direction, or rule of the common law under which interest *must* be paid on the value of the property of which the plaintiff has been defrauded, but the liability to make reparation, if an obligation at all, is an obligation upon which interest may or may not be paid, depending upon the exercise of judicial discretion. (*King v. Southern Pacific Co.,* 109 Cal. 96, 41 Pac. 786, 787-8.)

The fact that in a given case the court may exercise this discretion in favor of the plaintiff does not in any way affect the question. The obligation which in this case is said to have borne interest is the tort liability to pay damages, not the judgment debt into which it was merged; and the nature of that liability, as to whether or not it was "interest-bearing," must be determined by viewing it as it existed prior to the judgment. Until this "obligation" was extinguished by merger in the judgment, it could not possibly have been regarded as "interest-bearing."

The principal value, however, of the *Stockholms Enskilda Bank* case is as a pertinent illustration of the rule, referred to in *Ginsberg & Sons v. Popkin,* 285 U. S. 204, 208, 76 L. ed. 704, 708, as a "cardinal" rule of construction, that effect and meaning should, if possible, be given to every part of a statute. It follows that the word "interest-bearing," in the phrase "interest on interest-bearing obligations," cannot be ignored or disregarded, as the Circuit Court of Appeals has done in this case. To give the word meaning a distinction must be recog-

nized between interest on "interest-bearing obligations" and interest derived from non-interest-bearing obligations. The $398,079.71 here in question, if it be interest at all, is an extreme example of interest derived from a non-interest-bearing obligation. There are only three types of "interest" even under the broadest definition of that term. As stated in 15 *Am. Jur., Damages,* p. 577:

> "Generally speaking, interest is of two kinds: (1) That which is given by reason of a contract by the parties providing for the same, and (2) that which is given by way of damages. It has also been held that interest may be decreed by statute as a substantial right."

Interest received under a contract providing therefor is clearly interest on an interest-bearing obligation. *Helvering v. Stockholms Enskilda Bank, supra,* holds that interest decreed by statute as a substantial right is also interest on an interest-bearing obligation. And now the Circuit Court of Appeals, in the instant case, holds that interest awarded as damages is interest on an interest-bearing obligation. If this decision is correct, under what conceivable circumstances could interest be derived from an obligation which is *not* interest-bearing?

Certainly Congress did not intend, in enacting Section 119(a), to include all interest; otherwise, the qualifying language "on bonds, notes, or other interest-bearing obligations" would not have been used. This qualification, thus explicitly stated, should not be ignored or disregarded. It is the solemn expression of the legislative department of the government and as such must be given effect.

C. The $398,079.71 Was Not a Periodical Gain.

The respondent contends that even if the $398,079.71 was not an "amount received * * * from sources within the United States as interest," within the meaning of the portion of Section 211(a)(1)(A) hereinabove discussed, it was taxable under the section as "other fixed or determinable annual or periodical gains, profits, and income." In order to evaluate this contention, it is necessary to consider briefly the history of Section 211(a).

Under the Revenue Act of 1934, and under prior revenue acts for many years, nonresident alien individuals were taxed at the same normal and surtax rates, and were entitled to the same deductions, personal exemptions and credits, as citizens and residents of the United States, the sole difference being that such aliens were taxable only on income from sources within the United States and that their deductions were limited accordingly. The tax on certain types of income was required to be withheld and paid at the source, but the taxpayer was also required to file a return of *all* income from sources within the United States and to pay the additional tax thereon.

In practice, this method was very unsatisfactory. Those nonresident aliens whose deductions, personal exemptions and credits would entitle them to a refund of a portion of the taxes already withheld at the source usually filed returns and claimed the refund; but other nonresident aliens frequently neglected to file returns, and the Treasury Department had no way of enforcing their liability for additional taxes which might be due. The Revenue Act of 1936 sought to correct this embarrassing situation, in the case of those nonresident aliens who were

not engaged in trade or business within the United States and did not maintain an office or place of business therein, by (1) substituting, in place of the normal four per cent tax and surtaxes on net income, a flat ten per cent tax on gross income, and (2) restricting taxable gross income (with certain minor exceptions not here involved) to those types of income on which the tax was already required to be withheld and paid at the source.

A discussion of this drastic revision in the method of taxing nonresident alien individuals will be found in an article by Eldon P. King, Special Deputy Commissioner of Internal Revenue, in *The Tax Magazine*, Vol. 14, pages 589-590, and a more comprehensive review of the subject will be found in the 1939 supplement to Paul & Mertens, *The Law of Federal Income Taxation*, at pages 1829-1845.

In order to eliminate the unenforceable provisions of previous revenue acts requiring nonresident aliens to file income tax returns and pay additional taxes, Congress carefully copied into Section 211 the exact language used in Section 143(b) to describe the types of income subject to withholding of tax at the source, to-wit:

> "* * * interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income * * *."

The House Ways and Means Committee, in reporting the bill (H. R. No. 2475, 74th Cong., 2d Session; C. B. 1939-1, Part 2, p. 677) said:

> "This tax (in the usual case) is collected at the source by withholding as provided for in section 143."

The qualification, "in the usual case," was necessary because of the special treatment given in Section 143 to interest on tax-free covenant bonds and dividends of foreign corporations. With these exceptions, however, the Committee clearly manifested the intent to restrict the types of income subject to taxation to those on which the tax could be collected at the source.

The taxability under Section 211 of the income with which we are here concerned may, therefore, be determined by ascertaining whether or not a tax was required by Section 143(b) to be withheld and paid at the source. This preliminary conclusion is important because the provisions of Section 143(b) are found, in substantially the same form, in all of the revenue acts and have been interpreted by regulations and departmental rulings of long standing.

In view of the reference in the opinion of the Circuit Court of Appeals to "the contention of the taxpayer that the 'interest' is not a 'determinable annual or periodical gain'" [R. 96], it should be pointed out that the petitioner has never contended that the $398,079.71 in question was not "fixed or determinable" income. The contention is merely that it is not "annual or periodical" income.

In construing the phrase "fixed or determinable annual or periodical gains, profits, and income" in Section 211(a)(1)(A), the respondent has expressly adopted the

definition of the same phrase used in Section 143(b). Reg. 103, Section 119.211-7(a) reads as follows:

> "As to the determination of fixed or determinable annual or periodical income see Sec. 119.143-2."

Section 119.143-2 defines annual or periodical income by saying:

> "The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals."

This construction of the phrase "annual or periodical income" as requiring periodical *payment* is supported by specific rulings. O.D. 907 (C. B. 1921-1, p. 232) holds

> "that the commission paid on account of a single transaction is not fixed or determinable annual or periodical income."

In S. M. 975 (C. B. 1919-2, p. 184), it was held that winnings of race-horses credited to a nonresident alien owner and trainer are not fixed or determinable annual or periodical income. Quite recently, in G. C. M. 21575 (C. B. 1939-2, p. 172), the above rulings were reaffirmed when an opinion was requested as to whether prizes awarded by an art institute to nonresident alien artists were subject to withholding. After quoting the above language from the regulations, the General Counsel said:

> "In S. M. 975 (C. B. 1, 184 (1919)) it was held that amounts won in horse races in the United States by horses belonging to a non-resident individual were not subject to withholding under the Revenue Act of 1918. Such amounts were considered not to constitute 'annual or periodical income.' In O. D. 907 (C. B. 4, 232 (1921)) it was held that a commis-

> sion paid on account of a single transaction was not 'fixed or determinable annual or periodical income' within the meaning of section 221(a) of the Revenue Act of 1918.
>
> "It is the opinion of this office that the prizes awarded by the M Institute to nonresident alien artists during the years 1936, 1937, and 1938 do not come within the meaning of the term 'fixed or determinable annual or periodical income.'"

Petitioner, however, does not rest her case upon the foregoing rules requiring periodical *payment*. A tax may well be due in the hypothetical case put by the Circuit Court of Appeals [R. 96] of "interest received upon a demand note," for in the case of a note bearing interest payable only at maturity, the interest *accrues* periodically. (*Miller & Vidor Lumber Co. v. Commissioner* (C. C. A. 5), 39 Fed. (2d) 890, 892.) But even if the true test of periodical income is that it accrues periodically, the $398,079.71 in question would not be periodical income, for something more than the disputed assertion of a claim is needed to constitute accrued interest.

The period of delay for which the $398,079.71 was compensation extended over many years, but if the petitioner had been filing returns during this period on an accrual basis, she could not have been required to pay a tax on portions allocated to each fiscal year, for during this period there did not arise a fixed or unconditional right to receive any part of the $398,079.71. That was the test of accrual recognized by this Court in *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 76 L. ed. 1197, and *United States v. Safety Car Heating & Lighting Co.*, 297 U. S. 88, 80 L. ed. 500.

In *North American Oil Consolidated v. Burnet, supra*, the rule was stated as follows (286 U. S. p. 423, 76 L. ed. p. 1200):

> "The net profits were not taxable to the company as income of 1916. For the company was not required in 1916 to report as income an amount which it might never receive. See Burnet v. Logan, 283 U. S. 404, 413, 75 L. ed. 1143, 1147, 51 S. Ct. 550. Compare Lucas v. American Code Co., 280 U. S. 445, 452, 74 L. ed. 538, 541, 67 A. L. R. 1010, 50 S. Ct. 202; Burnet v. Sanford & B. Co., 282 U. S. 359, 363, 75 L. ed. 383, 386, 51 S. Ct. 150. There was no constructive receipt of the profits by the company in that year, because at no time during the year was there a right in the company to demand that the receiver pay over the money. Throughout 1916 it was uncertain who would be declared entitled to the profits. It was not until 1917, when the District Court entered a final decree vacating the receivership and dismissing the bill, that the company became entitled to receive the money. Nor is it material, for the purposes of this case, whether the company's return was filed on the cash receipts and disbursements basis, or on the accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive."

And in the *Safety Car Heating & Lighting Co.* case the Court said (297 U. S., pp. 93-94, 99, 80 L. ed. pp. 504, 507):

> "Until July, 1915, the existence of any liability was contested and uncertain. The amount remained contested and uncertain until May, 1925, when there was a settlement of the liability reported by the Mas-

ter. Then for the first time the profits flowing from the infringement became taxable as income. North American Oil Consolidated v. Burnet, 286 U. S. 417, 423, 76 L. ed. 1197, 1200, 52 S. Ct. 613; Lucas v. American Code Co., 280 U. S. 445, 451, 452, 74 L. ed. 538, 541, 542, 50 S. Ct. 202, 67 A. L. R. 1010; Lucas v. North Texas Lumber Co., 281 U. S. 11, 74 L. ed. 668, 50 S. Ct. 184; Burnet v. Huff, 288 U. S. 156, 77 L. ed. 670, 53 S. Ct. 330.

* * * * * * * *

"In February, 1913, if our analysis of the facts is accurate, there was a contested and contingent claim for profits, not fairly to be characterized as income for that year or earlier. In 1925, this inchoate and disputed claim became consummate and established. It was now something more than a claim. It was income fully accrued, and taxable as such. Till then the patentee had its capital, the patent, and an expectancy of income, or income, more accurately, in the process of becoming. Thereafter it had something different. No doubt the income thus accrued derived sustenance and value from the soil of past events. We do not identify the seed with the fruit that it will yield.

"Income within the meaning of the Sixteenth Amendment is the fruit that is born of capital, not the potency of fruition."

The Circuit Court of Appeals, however, rested its decision upon a peculiar distinction. It said [96]:

"The taxpayer also contends that the interest from the sales' dates is not payable until the judgment, and hence, because not periodical 'income,' such interest is not a 'periodical gain.' The Act specifically applies to 'periodical gain' as distinguished from periodical 'income.'"

Petitioner submits that this distinction is entirely fallacious. The phrase "gains, profits, and income" can be traced back to Section 90 of the Act of March 3, 1863, 12 Stats. 713. It was explained to the Congress which enacted that law as follows (Cong. Globe, 37th Cong., 2d Sess., p. 1531):

> "The words 'gain' and 'income' mean the same thing. They are equivalent terms."

The specific language used in Section 211(a)(1)(A), "fixed or determinable annual or periodical gains, profits, and income" is found in the withholding provisions of each of the previous revenue acts and had its origin in the first income tax law enacted under authority of the Sixteenth Amendment. Section II(E) of the Act of October 3, 1913 (38 Stats. at L. 166, chap. 16) provides as follows:

> "All persons . . . having the control, receipt, custody, disposal or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remunerations, emoluments, or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, . . . are hereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed by this section . . ."

The report of the Committee of Ways and Means on the 1913 Act clearly indicates that the words "fixed or determinable" and the word "annual" were intended to qualify and restrict the preceding language. The Committee said

(H. R. No. 5, 63rd Cong. 1st Session; C. B. 1939-1, Part 2, p. 2):

> "All annual gains, profits, and other fixed and determinable annual *income* derived from salaries, rent, interest, etc. whether payable annually, or semi-annually, or quarterly, or monthly, each constituting a transaction and business relationship running through the year, would be withheld at the source." (Italics ours.)

The provisions for withholding of tax at the source were re-enacted, in substantially their present form, as Section 221(a) of the Revenue Act of 1918. The Commissioner's interpretation of this section, as stated in Reg. 45, Art. 362, was as follows:

> "Only fixed or determinable annual or periodical *income* is subject to withholding." (Italics ours.)

This same interpretation appears, without change, in all subsequent income tax regulations, and is now a part of Reg. 103, Sec. 19.143-2.

The present provisions of Section 211 first appeared in the Revenue Act of 1936. Reg. 94, Art. 212-1(a), construing the 1936 Act, reads as follows:

> "A non-resident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time within the taxable year is taxable *only on gross income* from sources within the United States consisting of fixed or determinable annual or periodical *income*." (Italics ours.)

Only the arrangement of this language is different in Reg. 103, Section 19.212-1(a).

Thus, it appears that Congress and the Commissioner have consistently recognized that the words "gains" and "profits" merely describe particular types of income. And in *Merchants' Loan & Trust Co. v. Smietanka,* 255 U. S. 509, 65 L. ed 751, where the contention was advanced that a gain realized on the sale of securities could not constitutionally be taxed because the Sixteenth Amendment empowered Congress "to pay and collect taxes on incomes" and nothing else, this Court rejected the contention on the ground that the word "incomes" includes "gains."

Under Section 211(a)(1)(A) of the Internal Revenue Code "gains" are subjected to taxation. This means that they do not become gains until they accrue as income which Congress is permitted to tax. This Court has definitely determined that income does not accrue or come into existence until the right to receive it is unconditional. (*North American Oil Consolidated v. Burnet, supra; United States v. Safety Car Heating & Lighting Co., supra.*)

It follows that the sums included in the judgment against Fleishhacker and the bank as damages measured by interest did not become gains "annually or periodically," but only at the time they were received as income.

Conclusion.

The opinion filed by the Circuit Court of Appeals is in direct conflict with decisions of this Honorable Court as to the principles governing the determination of the issues presented. It is therefore respectfully submitted that a writ of certiorari should be issued and the decision of the Circuit Court of Appeals reversed.

BYRON C. HANNA,
HAROLD C. MORTON,
LEON B. BROWN,
Attorneys for Petitioner.